No. 15271

In the

United States Court of Appeals

For the Ninth Circuit

OREGON PLYWOOD SALES CORPORATION,

Appellant,

v.

SUTHERLIN PLYWOOD CORPORATION and NORDIC PLYWOOD, INC., *Appellees.*

APPELLEES' BRIEF

Appeal from the United States District Court for the District of Oregon

HONORABLE GUS J. SOLOMON, Judge

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SUBJECT INDEX

TABLE OF CASES

TABLE OF CASES—(Continued)

TABLE OF CASES—(Continued)

PAGE

RULES, TEXTS AND OTHER AUTHORITIES

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APPELLEES' STATEMENT OF THE CASE

Because the statement of the case set forth in Appellant's Brief (pp. 2-7) is incomplete, argumentative and in some respects inaccurate, the following statement is submitted to the court: [1]

Appellant, Oregon Plywood Sales Corporation, purchases plywood from plywood manufacturers, includ-

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1 In keeping with their descriptions in Appellant's Brief, appellee Sutherlin Plywood Corporation will be referred to as Sutherlin and appellee Nordic Plywood, Inc., will be referred to as Nordic.

ing its parent corporation, Oregon Plywood Corporation. Its purpose in doing so is to resell that plywood to others (Finding II, R. 51). Its method of operation, at least with Sutherlin, was to obtain an order from one of its customers, place its own order therefor with the manufacturer and require that shipment be made direct to the ultimate purchaser (see Exs. 125, 126). Its activities, then, partook of the nature of both wholesaler and broker.

Sutherlin had completed construction of a "plywood lay-up mill" at Sutherlin, Oregon, in October, 1953. Its operations involved employing primarily its stockholders for its labor force (Finding X, R. 55; R. 169). It lacked working capital when it was first contacted by Robert F. Hofheins (Vice-president, Treasurer and a Director of Oregon Plywood Corporation, and Secretary, Treasurer and a Director of appellant), and this was the fact, known to all concerned, which brought these organizations together (Finding II, R. 51; R. 72). Although Sutherlin's balance sheet at that time showed a net worth of $464,527.69, it also showed that the assets were made up largely of fixed assets and equipment being purchased on installment contracts, that included in the computation of "assets" was $19,452.26 "organization expense" and that its capital was in fact impaired (Ex. 131-A).

The contracts which resulted from these circumstances were the following, all executed on December 17, 1953:

1. A sales contract with appellant, here alleged to have been breached, which provided that

> "In consideration of the benefits to be derived by each party hereto, Party of the First Part [Sutherlin] gives and grants unto Party of the Second Part [appellant] the right to purchase up to 80% of the *output* of Party of the First Part when Party of the First Part gets into production, and Party of the First Part agrees to accept up to 80% and ship Party of the Second Part's orders as specified and within a reasonable time." (Ex. 1; it is set out at length R. 12-17)

2. A loan agreement with Oregon Plywood Corporation which provided for two types of loans to Sutherlin, namely, the loan of $80,000 to be secured by notes and a mortgage at 4 per cent interest, and the advance of the cost of green veneer (security title retained therein by lender) at no interest (Ex. 2).

3. A note to Oregon Plywood Corporation for the first $50,000 loaned (Ex. 114).

4. An open-end mortgage to Oregon Plywood Corporation to secure said note and future loans (Ex. 115).

The sales contract (Ex. 1), while requiring Sutherlin to sell 80 per cent of its output, did not require ap-

pellant to purchase anything. Other than the illusory promises of appellant to "advance" part of the invoice price of the plywood which it might decide to order and to use its "best effort" for Sutherlin, the only consideration for the sales contract was embodied in the promises of Oregon Plywood Corporation in the loan agreement (Ex. 2) and in the loans and advances made by it (not appellant) pursuant thereto. This fact gave rise to appellees' contentions below that the extra 5 per cent discount off the wholesale jobber's market price which Sutherlin was bound to give appellant was induced solely by loans of money and, in effect, constituted usurious interest. (No findings were made on that contention by the trial court.)

The record does not disclose whether Robert F. Hofheins procured these loans and advances acting as an officer and director of appellant, as seems to be contended by plaintiff (see Pre-trial Order, R. 31, and App. Br., pp. 2-3). He signed each agreement on behalf of the corporation with which it purports to have been made. Likewise, there was no evidence that appellant, as distinguished from its parent corporation, agreed to obtain these loans.

In January, 1954, Sutherlin commenced to operate its newly constructed mill. So long as it operated the mill it sold to appellant at least 80 per cent of its actual

output (Finding X, R. 55; R. 85). Operations were unprofitable from the beginning, however, and by April 21, 1954, it had lost therefrom more than $110,000, had exhausted its working capital and credit, and had twice failed to meet its payroll on time. Its average loss had been $34.02 per thousand board feet of plywood produced. With its available cash completely depleted, and finding it impossible to continue, Sutherlin terminated production on that date and since that time has had no output (see Finding X, R. 54-55; Exs. 131-C to 131-G).

Numerous and concentrated efforts to obtain additional financing to reopen the mill after April 21, 1954, understandably met with no success (Findings XIV, R. 56, and XV, R. 57; R. 127, 179, 192, 193, 226). In June, 1954, the stockholders authorized the directors to seek to sell or lease the mill; on July 28, 1954, the directors (at a meeting attended by appellant's officer and director, Robert F. Hofheins) recommended a sale or lease of substantially all the assets of the corporation; and in early August, 1954, the corporation accepted an offer from J. R. Adams and Norman Jacobson for the sale and purchase of its physical assets. That offer had been made pursuant to the invitations of Sutherlin (Findings XVI, XVII, XVIII, R. 57-58). Thereafter, Messrs. Adams and Jacobson caused Nor-

dic to be incorporated and the sale was made to Nordic in September, 1954, for $660,000, payable $20,000 down and $5,500 a month without interest. Under this sale the installments on the purchase price are paid into escrow and distributed to creditors and any remaining equity will ultimately be distributed to Sutherlin and its stockholders. The loans from Oregon Plywood Corporation were paid and a new mortgage taken by a bank (Findings VII, XIX, XXI, R. 53, 58-59; Exs. 120, 121, 122, 123 and 124).

There is no organizational relationship between Sutherlin and Nordic and they have no common officers, directors or stockholders (Finding XIX, R. 59).

The trial court rejected appellant's contentions that by these acts Sutherlin had breached the sales contract and Nordic had unlawfully interfered with and induced the breach thereof. It construed the contract as an output contract whereby Sutherlin was bound to sell only 80 per cent of its actual production and had not agreed expressly, impliedly or otherwise to continue production. Therefore, Sutherlin could shut down and cease operations and could sell its mill if it should determine to do so in good faith and in the exercise of honest business judgment. The court did *not* hold, as appellant asserts, that financial difficulties are an excuse for non-performance *generally*. As the context of

the colloquy between court and counsel quoted in Appellant's Brief (pp. 4, 43) and Conclusions of Law II, III, IV, V, VI, and VII show, Sutherlin's losses were held an "excuse" in this case because they were the reasons for the decisions to cease operations and sell the mill. That is, these are the facts which negative appellant's contention of bad faith and support the findings of good faith.

The court found as a fact that Sutherlin acted in good faith (Finding XXIII, R. 59) and concluded that appellant had failed to prove its contention of bad faith (Conclusion V, R. 64). It also found that Sutherlin in fact had become disabled from having an output long prior to Nordic's appearance on the scene (Finding XXII, R. 59) and that Sutherlin, not Nordic, was the moving party in effectuating the sale of the mill (Findings XVI, XVII, XVIII and XIX, R. 57-58 [2]).

QUESTIONS INVOLVED

The eight most important specifications of error (I through VIII) relate to findings of fact made by the trial court which were based upon evidence in the record. Of course, such findings will not be set aside

2 These findings are not challenged by appellant.

unless appellant bears the burden of showing that they are "clearly erroneous."

Rule 52(a), *Federal Rules of Civil Procedure.*

Grace Bros. v. Commissioner of Internal Revenue (CA 9, 1949) 173 F (2d) 170, 174

Findings of fact are not "clearly erroneous" unless unsupported by substantial evidence, clearly against the weight of the evidence or induced by an erroneous view of the law. In determining the correctness of the findings, the appellate court looks only to the evidence most favorable to them and such reasonable inferences as may be drawn from such evidence.

2 Barron and Holtzoff, *Federal Practice and Procedure* (1950) 834

Lewis Mach. Co. v. Aztec Lines (CA 7, 1949) 172 F (2d) 746

The only questions involved on this appeal are

(1) Did the trial court properly construe the meaning of the sales contract? Appellees contend that it did.

(2) Did Sutherlin act in bad faith in shutting down, ceasing operations and selling its mill? Appellees contend that there is no evidence of bad faith and that all the evidence supports the ultimate finding

(Finding XXIII, R. 59) that Sutherlin acted in good faith.

(3) In the event of adverse answers to the foregoing questions,

a. was Nordic's purchase of the mill the proximate cause of any breach of the sales contract by Sutherlin, and, if so,

b. was Nordic privileged to purchase the mill? Appellees contend there could be no causal relationship and that justification has been established.

(4) In any event, is the relief suggested by appellant available? Appellees contend that appellant can not recover more than nominal damages and that injunctive relief would be inappropriate.

ARGUMENT

I. Sutherlin Did Not Breach Its Contract.

(See Specifications of Error Nos. I, II, III, IV, V, VI, IX, X, XI, XII, XIII and XIV)

A. The Output Seller Retains the Right to Control Its Operations in the Absence of Bad Faith.

This is not the first case, or even nearly the first case, in which a manufacturer has agreed to sell its "output" for a definite period of time but has found it necessary to cease operations and, in some cases, to dispose of its plant. Judging from the number of re-

ported cases dealing with them, a good share of these contracts, and the converse situation, requirements contracts, have resulted in litigation. Frequently the output buyer (or the requirements seller) has contended that implicit in such contracts is the obligation of the output seller (or the requirements buyer) to continue to operate its plant and that it may not, by refusing to operate or by selling its facilities, "destroy the subject matter of the contract." These efforts in the main have proved unsuccessful.

Although the courts are not entirely uniform in their approach to or treatment of these contracts, the great weight of authority holds that, in the absence of bad faith, the output seller and requirements buyer retain their rights to control their operations. In fact, we have made a diligent search, and, except in an opinion of one judge, opposed by the other two judges on the case, we have failed to find a single case involving an output or requirements contract, *with no stated minimum to be sold or bought*, which has imposed a duty to continue operations in the face of financial loss. The cases refusing to find any such duty are legion. One of them, *William S. Gray & Co. v. Western Borax Co.* (CCA 9, 1938) 99 F (2d) 239, was decided by this court. Several cases decided by the Oregon Supreme Court, although not dealing with this precise situation,

imply that such is the law of Oregon. In view of the contentions made by appellant on this appeal, however, a review of the authorities seems in order.

1. *General Law.* Under modern authorities output and requirements contracts are not inherently void for lack of certainty or mutuality. The promise of a seller to sell his output and of a buyer to purchase his requirements may furnish consideration for a promise or act given in return. This, however, is placed upon the ground that, although such promisor *does not promise to sell any amount or to take any amount*, he nevertheless promises to suffer legal detriment: he relinquishes the right to have output or requirements and yet not sell or buy the same to or from the promisee.

1 *Williston on Contracts*, Rev. Ed. 353, § 104A
1 *Corbin on Contracts* 522, § 158

In fact the terms "output" and "requirements" are employed for the precise reason that the seller in an output contract or the buyer in a requirements contract wishes to retain the right to lessen or terminate his production or needs and the right to control his assets.

Annotation: 1 A.L.R. 1392-1397, "*Validity and construction of contract for sale of season's output*"

(p. 1393) "In construing contracts for the sale of the output of a manufacturing or producing plant

for a designated period of time, it is to be remembered that, by the use of this language, the parties to the contract have expressly refrained from contracting for the sale of any specific quantity of goods, material, or commodity. In this regard, however, the contract is not ambiguous, for the language used is clear. The term 'output' means the quantity of material put out or produced within a stated time. (See Century Dict.)"

See, also, supplementing the above annotation,

9 A.L.R. 276-278

23 A.L.R. 574-582

For similar treatment of requirements contracts, see

Annotation: 7 A.L.R. 498-516, "*Construction of Contracts for sale of commodity to the extent of the buyer's requirements,*" pp. 506, 507; supplemented 26 A.L.R. (2d) 1099-1131

Probably the leading modern case in this field is

In re United Cigar Stores Co. of America (D.C. N.Y., 1934) 8 F. Supp. 243, affirmed (CCA 2, 1934) 72 F. (2d) 673, cert. den. sub. nom., *Consolidated Dairy Products Company, Inc., v. Irving Trust Co.* (1934) 293 U. S. 617, 79 L. ed. 706

In that case, after refusing to adopt the requirements contract which bankrupt-buyer had with claimant-seller, the trustee moved to expunge claimant's claim against the bankrupt's estate. The contract, law-

yer-drawn, had provided that bankrupt would buy (and claimant would sell) all ice cream "required for its stores." Claimant had also agreed to sell to bankrupt, at over 50 per cent discount, 15,000 shares of claimant's stock and to give an interest in certain other stock options of another corporation. Bankrupt purchased its actual requirements from claimant until, during the term of the contract, it filed its voluntary petition in bankruptcy. The district court held that, although bankruptcy of a party to an executory contract does not excuse performance, here there had been no failure to "perform" because "requirements" were determined by the actual needs of the requirements-buyer, provided he did not act in bad faith. Reviewing the two main lines of authority, the district court stated as to the view it had adopted:

> (p. 244) "Subterfuges or evasions would doubtless not be tolerated, but the buyer's conduct in good faith determines his requirements. The same effect is given to output contracts; if the seller cuts down his manufacture or even closes up his plant in good faith, he has still performed his undertaking. The weight of authority supports this construction of the ordinary requirements contract and the ordinary output contract. H. M. Pfann & Co. v. J. C. Turner Cypress Lumber Co., 194 F. 69 (C. C. A. 5), certiorari denied in 225 U. S. 706, 32 S. Ct. 838, 56 L. Ed. 1266 (sale of business);" [citing numerous other cases]

As to the other view that reads into such contract an obligation to have requirements to *substantially the same extent as were its requirements when the contract was made*, the court stated:

> (p. 245) "On principle this view of the ordinary requirements contract and the ordinary output contract is difficult to justify. * * * If the parties had intended that the buyer should be bound to take goods according to his requirements in the past, they would have expressed that intention or would have inserted a specific quantity as the amount to be purchased. If they had intended that the buyer should be obligated to have future requirements, they presumably would have inserted a minimum quantity as is quite usual in contracts of this character (see Wigand v. Bachmann-Bechtel Brewing Co., 222 N. Y. 272, 118 N. E. 618; Louisville Soap Co. v. Taylor, 279 F. 470 (C. C. A. 6), or in some other manner have indicated that the buyer must continue to buy throughout the term."

Cited for support by the district court in the *United Cigar Stores* case was

H. M. Pfann & Co. v. J. C. Turner Cypress Lumber Co. (CCA 5, 1912) 194 Fed. 69, cert. den. (1912) 225 U. S. 706, 56 L. ed. 1266

Although this case is relegated by Appellant's Brief (p. 28) to not-even-up-to "ordinary" case status in appellant's four-fold classification, its similarity to the present case is striking. It involved an output contract for a definite term by which the defendant had agreed to sell (and the plaintiff to purchase) all of certain grades

of lumber (about 25 per cent of its total output) "as may be manufactured by them" for a period. In consideration of a loan of $6,000 the contract was extended to November 1, 1903, but on March 31, 1903, the defendant sold its plant and no longer had any production. There was no contention of bad faith. The court held:

> (p. 71) "The words do not import a promise to keep the mill in operation, nor to manufacture any quantity of lumber during the two years. Lumber manufactured by the mill of the grades in the contract specified, it was the duty of Pfann & Co. to sell and deliver to the Lumber Company at the contract price. But the words referred to cannot, by any reasonable rule of interpretation, be so construed as to divest Pfann & Co. of the right to dispose of their property in their own way and at any time deemed advantageous to themselves.
>
> "To construe the words so as to deprive them of the right to sell the plant, there must be interpolated in the contract language which the parties themselves have failed to employ. In other words, we would thus make a contract for the parties which they have not made for themselves. A right so important as that of one to sell his own property should not be denied him unless the language employed clearly conveys that intention."

The view of the foregoing cases was in effect adopted by this court as the governing rule for the Ninth Circuit, in the absence of applicable local cases, in

William S. Gray & Co. v. Western Borax Co. (CCA 9, 1938) 99 F. (2d) 239

The contract involved in that appeal arose when defendant manufacturer acquired large borax deposits. Upon developing mines thereon and a refining plant it sought to enter the competitive field of boron products. The plaintiff, which had an existing distributing business, was established by the contract as exclusive agent for sale "of all the borax, crude and/or refined, borac acid and other products produced by" the defendant. The contract, which was to "continue in effect for ten (10) years," did not specify any minimum amount defendant was to produce. Upon suffering financial reverses, the defendant contracted for sale of its mines, deposits and refineries and thereafter produced no boron products. Judgment for the defendant was affirmed. After citing certain analogous California decisions (governing local law), the court's opinion, by Judge Denman, stated as follows:

> (p. 243) "The reasoning of these California cases and of the authorities on which they rely, require us to hold that in this case the Borax Company did not agree to continue to produce from its properties and that there was no breach in their sale. If there was no such California opinion we would agree that its law is in accord with the opinion of the Fifth Circuit in Pfann & Co. v. Turner Cypress Lumber Co., 194 F. 69, 70, certiorari denied 225 U.S. 706, 32 S.Ct. 838, 56 L.Ed. 1266. * * *
>
> "The provision that the commission here is based on 'all' the borax 'produced' by appellee is identical

> in principle with the provision in the Pfann case for the purchase of 'all' the 'lumber as may be manufactured by them'."

The above quoted language of the *Pfann* case was quoted at length. The court found no bad faith.

Because of the absence of a duty on appellant's part to buy any of Sutherlin's production, there can be no distinction between the *William S. Gray* case and the present case based upon the sales agency nature of the contract involved (See R. 83).

Representative of the many decisions in accord with the good faith test and the principles above enunciated are

> *Forth Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corporation* (CCA 3, 1942) 130 F. (2d) 471 (75 per cent requirements contract; termination of operations as result of recession in defendant's business) and Pennsylvania cases cited therein.
>
> *William C. Atwater & Co., Inc., v. Terminal Coal Corporation* (D.C. Mass., 1940) 32 F. Supp. 178, affirmed (CCA 1, 1940) 115 F. (2d) 887 (coal requirements contract; sale of business after financial losses)
>
> *Southwest Natural Gas Co. v. Oklahoma Portland Cement Co.* (CCA 10, 1939) 102 F. (2d) 630 (gas requirements contract; change to new type of gas heating system resulting from exercise of business judgment)
>
> *Duboff v. Matam Corporation* (1947) 272 App. Div. 502, 71 N.Y.S. (2d) 134 (home appliance exclusive agency of all produced; liquidation and sale of business)

In accord with these views are the other cases classified in appellant's "second pattern" (App. Br., p. 28), and also the following cases which hold that even the insertion of an estimated quantity (held not to be a warranty) does not change the rule:

Brawley v. United States (1877) 96 U.S. 168, 24 L. Ed. 622 (requirements contract for "necessary" wood; estimate of 880 cords but only 40 cords required; good faith test)

Kenan, McKay & Spier v. Yorkville Cotton Oil Co. (CCA 4, 1919) 260 Fed. 28 (season's output contract; bad faith not shown)

Kenan, McKay & Spier v. Home Fertilizer & Cotton Oil Co. (1918) 202 Ala. 29, 79 So. 367 (season's output contract; "lack of due diligence" is not bad faith)

Kenan, McKay & Spier v. Yorkville Cotton Oil Co. (1918) 109 S.C. 462, 96 S. E. 524 (season's output contract; inability to borrow is not bad faith)

Cf. Dawson Cotton Oil Co. v. Kenan, McKay & Spier (1918) 21 Ga. App. 688, 94 S. E. 1037 (on demurrer, complaint charging bad faith held sufficient)

The single opinion which we have found suggesting that an output seller (or requirements purchaser), in the absence of a stipulated minimum to be sold or bought, must continue to operate in the face of financial loss is that by Judge Cotteral in

Central States Power & Light Corp. v. United States Zinc Co. (CCA 10, 1932) 60 F. (2d) 832, cert. den. (1932) 287 U. S. 660, 77 L. ed. 570

However, the concurring opinion of Judge Lewis in that case construed the contract as containing a minimum quantity, thereby taking the case out of the "requirements" class, and there was a strong dissent by Judge McDermott. Furthermore, in a subsequent case in the Tenth Circuit involving almost the same type of contract, the good faith test was invoked.

Southwest Natural Gas Co. v. Oklahoma Portland Cement Co. (CCA 10, 1939) 102 F. (2d) 630 (supra, p. 17)

2. *Oregon Law.* While the precise question involved in this case has not been decided by the Oregon Supreme Court, the following case strongly implies that the good faith test is the rule in Oregon.

Standfield v. Arnwine (1921) 102 Or. 289, 202 Pac. 559

Here the plaintiff-buyer and the defendant-seller had entered into a contract whereby plaintiff paid defendant a $5,000 deposit, and defendant covenanted to sell and deliver to plaintiff "about 3,800 head mixed lambs, being all of my 1918 crop." Defendant tendered 2,800 head, his entire 1918 crop. This was held sufficient. The court quoted at length from *Brawley v. United States* (1877) 96 U.S. 168, 24 L. Ed. 622 (supra, page 18) to the effect that the estimate was not a warranty, that the actual crop was the measure of performance and that all that is required of the producer in such case

is good faith. Also cited was *Kenan, McKay & Spier v. Home Fertilizer & Cotton Oil Co.* (1918) 202 Ala. 29, 79 So. 367 (supra, page 18).

In a similar case, *Otto Seidenberg, Inc. v. Tautfest* (1937) 155 Or. 420, 64 P (2d) 534, the court commented:

> "The evidence shows good faith on the part of the grower and the exercise of good husbandry in an effort to produce the maximum amount of hops contracted to be sold. The buyer was in no position to reject the hops by reason of the quantity." (p. 425)

3. *Appellant's Cases.* Appellant's four-fold classification of the "patterns of interpretation" (App. Br. pp. 27-32) is not Williston's, as suggested (App. Br. p. 27), but its own. Williston classifies those cases which take note of possible "disproportionate burdens" cast upon the output buyer if the output seller is left *entirely* free to operate or not as follows:

1 *Williston on Contracts,* Rev. Ed. 353, § 104 A

> "In other words, this view implies an obligation to carry out the contract in the way anticipated, and not for purposes of speculation to the injury of the other party, *but recognizes that either party may in good faith cease to have such output or requirements.*" (emphasis supplied)

The cases Williston contrasts with these cases are those which do not require even good faith on the part of the output seller.

Appellees have no objection to new analyses and classifications of the authorities; however, they are unable to grasp the distinctions which appellant draws. For instance, it is not apparent whether appellant has drawn the patterns according to (1) the factual differences in the cases or contracts involved, (2) the legal theories announced by the respective opinions cited, or (3) the issues actually before the court. Likewise, it is difficult to understand why the rules of those four patterns of cases "do not apply to this case" (App. Br. p. 27) if the present case "falls within the fourth pattern" (App. Br. p. 31).

Apparently, appellant does not rely upon the cases which it classifies in the "third pattern," and for good reason. In the first three cases cited in that group (App. Br. p. 29) the issue actually before the courts was whether the contracts lacked mutuality and the courts apparently felt impelled to suggest that there was some duy to have output or requirements in order to uphold the contracts. Such construction is unnecessary to effectuate that purpose. 3 *Corbin on Contracts*, 204-205, § 569.

Further, nothing in any of these "third pattern" cases indicates that there is liability for ceasing operations if the output seller is financially unable to continue. The reason for the sale of the steamers involved in *Wells v. Alexander* (1891) 130 N.Y. 642, 29 N.E. 142, (cited App. Br., p. 29) does not appear; subsequent cases applying New York law have distinguished the case, isolated it as an "exceptional case" or refused to follow it. See *William C. Atwater & Co., Inc. v. Terminal Coal Corporation* (D.C. Mass. 1940) 32 F. Supp. 178, affirmed (CCA 1, 1940) 115 F (2d) 887 (supra page 17), and New York cases therein cited; and *Duboff v. Matam Corporation* (1947) 272 App. Div. 502, 71 NYS (2d) 134 (supra, page 17). The jury instruction passed upon in *Hickey v. O'Brien* (1900) 23 Mich. 611, 82 N.W. 241 (cited App. Br., p. 29), was definitely contrary to the good faith test for it will be conceded that a sale of the plant "for the sole purpose of getting rid of" (82 N.W. 242) an output or requirements contract constitutes bad faith.

The underlying fallacy of these decisions, however, was demonstrated by the District Court's opinion in the *United Cigar Stores* case (supra, page 12):

> "There is another consideration. No case, so far as I know, has gone so far as to hold that the buyer is liable in case his requirements slump off in the course of the contract to one-half, one-third, or one-

> tenth of his former needs; and yet, if he is not liable in such a case, it is hard to see how he can be held liable where in good faith he ceases business altogether and thereafter has no requirements." (8 F. Supp. 245)

Finally, these "third pattern" cases, in their efforts to give effect to what they believe to have been the expectations of the parties, construe the agreement of the parties to require a *continuance* of existing needs or production and measure the duty assumed by the accustomed output or requirements *at the time of making the contract*. Such standard can have no meaning, however, in a case like the present one where the output seller had had no prior or "accustomed" output at the time of the execution of the contract.

Appellant asserts that its "fourth-pattern" cases differ from "ordinary" cases and, choosing two cases to so classify, seeks to apply their results to this case and thereby to extricate it from the principles above discussed. These two cases will be considered seriatim.

1. *Diamond Alkali Co. v. P. C. Tomson Co.* (CCA 3, 1929) 35 F (2d) 117, (cited App. Br. p. 30) is neither extraordinary nor comparable to this case. In the first place it will be noted that the authorities on which the *Diamond Alkali* case relies are the "third pattern" cases classified by appellant as "ordinary." As in all the other

cases finding an implied promise to continue operations, the court discerned an intention of the parties that the buyer's requirements would *continue* to be as great as in its *already existing business*. As pointed out above, this is meaningless to a new concern without an established output or requirements. Appellant emphasizes that, as in the present case, the contract was to "continue" for a definite period. Again, such provision hardly makes the case unique. Every case cited thus far under this heading has involved that factor.

In the second place, in a subsequent third circuit case, *Fort Wayne Corrugated Paper Co. v. Anchor Hocking Glass Corporation* (CCA 3, 1942) 130 F (2d) 471, 473, *Diamond Alkali* was rejected in favor of Pennsylvania cases (applicable local law) adopting the good faith test.

In the third place, the *Diamond Alkali* case actually involved bad faith and the court was quite cognizant of that fact. The defendant there did not cease to have requirements because of inability to continue but because "an unexpected opportunity to make 'an advantageous sale' presented itself" (35 F (2d) 119) in the form of an offer from the Ford Company. Sutherlin, on the other hand, as will be shown hereinafter, had no other alternative than to discontinue production (Finding XXIII, R. 60), and eventually negotiated a

sale at 3.3 per cent down and the balance at no interest (See Ex. 123) to a low capitalized purchaser. This can hardly be called an "unexpected opportunity" or an "advantageous sale." Further, the Tomson Company in the *Diamond Alkali* case retained a newly built plant, without any productive use being made of it, apparently for the sole reason that in the sale of *part* of its assets it sold its *good will,* coupled with an *agreeement not to engage in business* for the term of the contract. Such is not the case with Sutherlin. Presumably if it could operate, it would be bound today to sell 80 per cent of its plywood output to appellant.

2. *Texas Industries v. Brown* (CA 5, 1955) 218 F (2d) 510 (cited App. Br. p. 34) not only is not authority for appellant's position but also illustrates what may so easily be provided in a contract of this type if it is thought desirable to control the disposal of the seller's facilities.

In the *Texas Industries* case, decided on motion for summary judgment, it was alleged that the requirements buyers and those who took over the buyers' operations "deliberately arranged the transfer of the plants, pursuant to a scheme to deprive the appellant of its benefits"—a charge of bad faith. (The similar charge of appellant in this case, as found by the trial court and as will be shown below, is not supported by

the evidence.) No financial difficulties were involved and credence was given to the charge of bad faith by the following facts:

> "*The plants have not been sold; they have not been shut down;* they have not been dismantled; *they have never ceased to operate and to have requirements.* They are operating under a lease from the Browns, who signed the contract and *who are still very much interested as individuals in the operation of the plants.* Much of the value of the rights reserved to the lessor under the lease depends upon the continuing operation of the plants." (218 F (2d) 512) (emphasis supplied)

Sutherlin and Nordic have no organizational relationship (Finding XIX, R. 59) and the sale was at no interest.

Most important the contract in *Texas Industries* expressly provided:

> " '13. Nothing in this agreement contained shall prevent any party hereto from consolidating or merging its operation into another operation, or from changing the form of organization, or from selling, conveying, or exchanging its property as an entirety or substantially as an entirety, *but any and all such mergers, consolidations, organizational changes, sales, conveyances, or exchanges shall be binding upon the organization resulting from or succeeding to the ownership of the property as an entirety or substantially as an entirety,* * * *.' " (218 F (2d) 513) (Emphasis supplied)

The court cited *Portland Gasoline Co. v. Superior Marketing Co.* (1951) 150 Tex. 533, 243 S.W. (2d) 823, as indicating that under Texas law there was an implied obligation to operate. However, in that case the court so indicated only for the purpose of upholding the contract as not illusory and did not reject the good faith test. Further, that case involved an exclusive marketing contract such as that in the *Williams S. Gray & Co.* case (supra, page 16) which this court decided and in which the good faith test was adopted.

It may be conceded that a strong motive impelling a court to prevent the disposition by a seller (for collusive, capricious or speculative reasons) of the assets with which it has been producing its output, is the fear that otherwise disproportionate burdens will be cast upon the output buyer. However, contrary to appellant's contention, the present case tends entirely in the opposite direction. As pointed out in appellees' statement of the case (supra, page 4), the sole consideration for Sutherlin's obligation was the loan of money from appellant's parent corporation. The promise to "advance" a portion of the price of plywood *purchased by appellant* upon receipt of invoice and bill of lading (inappropriately designated in Appellant's Brief (p. 2) as "accounts receivable financing") is wholly illusory be-

cause such "advances" depended entirely on appellant's orders which it was not bound to give.

Ward v. McKinley (1920) 97 Or. 45, 191 Pac. 322

Inasmuch as appellant was free to purchase, and did purchase output of others, the "best effort" provision furnishes no conceivable standard of performance. Hence, it is too uncertain to be enforceable.

First Natl. Bank v. Hazelwood Co. (1917) 85 Or. 403, 166 Pac. 955

Barton v. Spinning (1894) 8 Wash. 458, 36 Pac. 439

Oregon Plywood Corporation's $80,000 loan, at 4 per cent interest, was fully and adequately secured by a first mortgage on Sutherlin's mill (Exs. 114, 115). Its advances for veneer, although aggregating approximately $216,000 during Sutherlin's operations, were necessarily short term advances which were doubly secured: (a) by the retention of security title to the veneer (Ex. 2); and (b) by the provisions of the sales contract and loan agreement (Exs. 1, 2) authorizing appellant to pay the veneer advances by applying thereto its 80 per cent "advance" on receipt of invoice and bill of lading, as well as the balance of the invoice price. In fact, this left little of the "Oregon Plywood" interests' money in the hands of Sutherlin. (See for the

workings of these provisions R. 150, 157-158 and compare "accounts receivable, brokers" and "accounts payable, brokers" in Sutherlin's monthly balance sheets, Ex. 131-C to 131-G).

Nevertheless for these two loans of money appellant obtained effective control over Sutherlin's operations so long as Sutherlin could stay in business. It could sell 80 per cent of its output to no one but appellant, but appellant could take that output or not according to its desires. It was not upon appellant but upon Sutherlin that disproportionate burdens were cast.

In any event, appellant's commitments hardly take the case out of the general rules governing these contracts. The *Pfann* case (supra, page 14) involved a loan by the buyer to the output seller. In the *United Cigar Stores* case (supra, page 12), contrary to appellant's assertion (App. Br. pp. 30-31), in addition to the promise to sell the buyer's requirements, the claimant-seller had agreed to sell 15,000 shares of its stock at more than $290,000 below its existing selling price on the stock exchange. So also, in the *Fort Wayne Corrugated Paper* case (supra, page 17) the requirements seller had not only advanced money but had leased a plant from the requirements buyer, expanded its plant and refrained from dealing with others.

Again, if (as appellant contends) the basis of the decisions in *Diamond Alkali* and *Texas Industries* was the degree of reliance placed by one of the parties upon the expected continued production, the present case fails to reach them. There are obvious and basic differences between the loans made here and the sale of land and enlarging of a plant in *Diamond Alkali* and the building of a new plant in *Texas Industries*, especially in the absence here of a duty to buy Sutherlin's production.

Professor Corbin has analyzed the problem with his customary insight. Referring to output and requirements contracts and the "gap" as to whether continuous operations were guaranteed, he states:

> "In both of these classes of cases the courts have generally answered the questions in the negative. They leave the gap unfilled; no such promises are implied. * * *
>
> "If it were necessary to make such an implication in order to maintain the validity and enforceability of the agreement, it should be made; but it is not necessary for that purpose. If it were necessary in order that the contract should not be unreasonable or unfair to one of the parties (the seller) according to prevailing standards and usage, the implication should be made; but it is not necessary for that purpose. If such agreements, in spite of the unfilled gap, were commonly so understood and performed by business men, the additional unstated duty and burden should be put upon the buyer

by implication; but no such understanding or performance can as yet be shown.

"Here, then, is a gap that should not be filled by the court. The implication suggested might not be unreasonable—at least the added promise is one that men sometimes make in words; but refusal to make the implication does not make the contract unenforceable, unreasonable or one-sided. The seller may be quite willing to trust to the self-interest of the buyer, to his desire to continue a profitable business, and to his promise to buy exclusively of the seller, without any further promise on the buyer's part. The risk of there being no needs or requirements the seller may be quite willing to carry; and he can adjust his prices in proportion to the risk.

"Only the least thought is necessary to realize that a 'gap' in an agreement should not be filled merely because a gap exists. No promise, or condition of a promise, should be added by either implication or judicial construction, merely because the parties did not put it into their words of agreement." 3 *Corbin on Contracts* 204-205, § 569

B. Sutherlin did not Promise, Expressly or Impliedly, that it would Continue to have an Output.

The contention that this contract "expressly requires" continuous operations differs from the arguments made in most of the cases above cited only in the label attached to it. The construction advanced still requires one to read into the contract a provision which is not there.

1. *The "full force and effect" provision.* The provision that "this contract shall be in full force and effect" for a definite period is not unlike that in every case hereinbefore cited. It is remarkably similar to that in *William S. Gray & Co. v. Western Borax Co.* (CCA 9, 1938) 99 F (2d) 239 (supra, page 16). If they did not have a definite term, these contracts would be void for lack of certainty, and if the termination of production or sale of plant had not occurred during the time the "contract" was "in full force and effect" there would have been no law suits. The question raised here is not how long the contract is "in full force and effect" or whether Sutherlin was obligated to a "standard of performance," but rather what that standard of performance is in a contract that admittedly is still in effect. *In re United Cigar Stores Co. of America* (D.C. N.Y., 1934) 8 F. Supp. 243, (supra, page 12).

2. *The mortgage term and casualty provisions.* Appellees readily agree that the term of the mortgage and term of the contract were intended to be the same and that this was to be so regardless of whether Sutherlin operated or not and even if the inability to operate was because of "fire, earthquake, disaster or act of God."

Appellees cannot agree, however, that because the "contract" was to "continue in full force" in those

events it is proper to infer that "temporary inability to produce was not to relieve Sutherlin from the duty to *continue in operation*" (App. Br. p. 21; emphasis supplied). The thing that appellant continues to ignore is that there is a difference between *performing* an output contract, that is, selling what the output is, and *continuing to operate.* In fact, the provisions referred to illustrate that difference. They show that the parties understood that Sutherlin could be "unable to produce" and yet the contract could "continue in full force."

As shown above, page 29, Sutherlin's need for working capital led it to subject itself substantially to the will of appellant, but it is inconceivable that in its position its officers would have taken from it a defense even for "acts of God." As stated by this court in the *William S. Gray & Co. case* (supra, page 16):

> "Appellant's contention in effect is that appellee not only must retain ownership of the borax properties but that it must continue to 'produce' from them to yield a profitable commission to appellant no matter what losses appellee may suffer from the failure of appellant, its exclusive agent, to procure sales yielding a profit to the appellee. * * *
>
> "It is against business common sense that the parties would make an agreement to continue production or remain in the business in these circumstances." 99 F (2d) 242

It is also unlikely that appellant or its representative, Robert F. Hofheins, believed that any such duty was assumed by Sutherlin. As found by the trial court (Finding VIII, R. 53) they had had extensive experience in the plywood industry and knew of Sutherlin's weakness and the possibility it could not continue to operate. The provisions of the contracts themselves show that both parties were aware of these facts. Further support for this finding's recognition of appellant's knowledge of the situation and Sutherlin's weakness, comes from the evidence that Mr. Hofheins had entered into other output contracts (R. 107) and was shown the financial statements of Sutherlin as of October 31, 1953 (Ex 131-A; R. 203).

Further, the obvious motive for and objective of these provisions was not to require continuous operations but to protect and enhance the "Oregon Plywood" investments. Under the contract appellant was to receive a 5 per cent discount off the wholesale jobber's market price—5 per cent lower than any other buyer—in return only for the loan of money (by its parent corporation). This is a remarkably high return on $80,000 in loans (at 4 per cent interest) and short term veneer advances. As shown by Exhibit 146 it amounted to $13,-413.81 in three and one-half months (see R. 185). With the knowledge that money to make the mortgage pay-

ments must come from operations and sales to appellant (the payments were to be deferred if insufficient orders were furnished), the "Oregon Plywood" interests simply insured by these provisions that so long as their money was invested they would receive the extra 5 per cent discount on the output of Southerlin.

3. *The accept and ship provision.* Appellant also points to the provision that Sutherlin would accept and ship appellant's orders. The full provision in question is that Sutherlin (First Party) grants to appellant (Second Party)

> "* * * the right to purchase up to 80% of the output of Party of the First Part when Party of the First Part gets into production, and Party of the First Part agrees to accept up to 80% and ship Party of the Second Part's orders as specified and within a reasonable time." (Ex. 1)

What orders was Sutherlin to accept and ship? Up to 80 per cent of what? Appellant's Brief is significantly silent on that point. Although this provision was not as artfully drawn as it might have been, it seems clear that they were orders for the same 80 per cent already mentioned, namely, 80 per cent of *output*. The case of *Kanaskat Lumber & Shingle Co. v. Cascade Timber Co.* (1914) 80 Wash. 561, 142 Pac. 15, involved a contract with a similar provision. The seller agreed "to furnish to the party of the second part all the cedar logs cut

by it" in a certain area, and further agreed "to cut cedar logs as they are reached in the logging operations * * * and to deliver the logs cut." It was held that seller's duty was to sell only such logs as were actually cut, *if any*.

We have searched appellant's brief for an indication of just how much continuous output Sutherlin is supposed to have promised and the measure of its supposed duty to appellant. The only indication is found in its asserted measure of damages—that is, that it is entitled to damages of 5 per cent of the price of orders which the mill "could have handled" (App. Br., pp. 49-50), less expenses. In other words, the contention is that this is not an 80 per cent-of-*output* contract, but an 80 per cent-of-*capacity* contract. The immediate question is: If the parties meant "capacity" why did they say "output"? The answer is that they didn't intend it and had intentionally chosen the term output. In fact, the loan agreement, which was executed at the same time as the sales contract (Findings III and IV, R. 25-26; R. 79), shows that the parties had specifically considered the possibility that Sutherlin would not operate and would not accept orders for 80 per cent of its *capacity*, and, also, what was considered an ample remedy therefor to the "Oregon Plywood" interests. It provided:

> "In the event that Party of the Second Part [Sutherlin] does not operate for a period of ninety (90) days and/or does not accept orders up to 80% of *capacity* from Oregon Plywood Sales Corporation for reasonable prompt shipment * * *, then any unpaid balance due Party of the First Part [Oregon Plywood Corporation] may become due and payable within sixty (60) days at Party of the First Part's option, * * *." (Ex. 2); (emphasis supplied).

These were formal, lawyer-drawn documents. By elementary rules of construction, the parties must be held to have intended that the remedy of acceleration of the mortgage was an exclusive one for the failure to operate at all or at capacity.

Finally, it is quite apparent that appellant intentionally sought to provide for the contingency of failure to operate by means much more subtle than a direct provision requiring continuous operations. Through the provisions (a) for representation on Sutherlin's board of directors, and (b) for acceleration of the mortgage, it could do considerable to control the production policies of Sutherlin. This control was to be *indirect* only. It is unlikely that Sutherlin would have acceded to the more pervasive direct restraint on its normal corporate rights.

C. Appellant made no Showing of Bad Faith and the Evidence Supports the Finding of Good Faith.

(See Specifications of Error Nos. II, III, IV, V, VI, XII and XIV)

1. *The test.* Appellant complains that Sutherlin could have operated because it still had an excess of assets over liabilities (excluding capital stock) and because the plywood market improved in the summer of 1954 and remained firm until the time of trial. Aside from the finding, amply supported by evidence to be cited hereinafter, that Sutherlin had become unable to continue production (Finding XXII; R. 59), appellant misses the point. The test is not whether operations were possible, or even whether reasonable men would have continued them, but rather it is whether the decisions not to continue and to sell were made in good faith. To find bad faith the decisions must have been for the sole purpose of depriving the buyer of the benefits of the contract. As to this, the buyer asserting the breach of an output contract has the burden of proof. Decisions made in the exercise of *honest* business judgment do not constitute bad faith.

William S. Gray & Co. v. Western Borax Co. (supra, page 16, at 99 F (2d) 242)

In re United Cigar Stores Co. of America (supra, page 12, at 8 F. Supp. 244, 245, and at 72 F (2d) 675)

William C. Atwater & Co., Inc., v. Terminal Coal Corporation (supra, page 17, at 32 F Supp. 183 and at 115 F (2d) 888)

Southwest Natural Gas Co. v. Oklahoma Portland Cement Co. (supra, page 17, at 102 F (2d) 633)

Kenan, McKay & Spier v. Yorkville Cotton Oil Co. (supra, page 18, at 96 S.E. 526)

There is no evidence that the decisions to terminate production and sell the mill were not the result of honest business judgment.

2. *The facts.* Regardless of whether appellant had the burden of showing bad faith or appellees were required to show good faith, the finding of good faith is amply supported by the evidence. Sutherlin's plight has been summarized in Appellees' Statement of the Case (supra, page 5). A few of the particulars will be listed here:

(a) From the beginning Sutherlin was weak financially. The balance sheet of October 31, 1953, (Ex. 131-A), lists a surplus of $332.69; however, included in the list of assets is the item "organizational expense" in the amount of $19,452.26. By deducting this item, which is not a genuine asset, it is seen that Sutherlin's capital was actually impaired on that date by a deficit exceeding $19,000 (Finding XIII, R. 56). This balance sheet was shown to Robert F. Hofheins, treasurer for

both appellant and Oregon Plywood Corporation prior to the execution of the contracts here involved (R. 53, 203).

(b) More important than the fact that its capital was at all times impaired was its *poor current position.* As shown by its balance sheet of that date (Ex. 131-A) on October 31, 1953, it had $44,662.46 in current assets, including $15,207.22 cash and $21,676.27 in stock subscriptions receivable.

(c) By December 31, 1953, after receiving $50,000 of the long-term loan provided for in the loan agreement (Exs. 2, 114) its current position was improved to $95,269.48 current assets, including $49,322.34 cash, and $95,870.38 current liabilities (Ex. 131-B).

(d) By January 31, 1954, after a month of operation, its current position had declined to $130,464.44 current assets—including $32,185.82 cash, and $151,848.29 current liabilities—including $54,333.27 owed to Oregon Plywood Corporation for veneers (Ex. 131-C; supporting data in Ex. 132-B). As shown by the Income Account for January, 1954, (Ex. 131-C), losses for that month totaled $22,337.50 and had averaged $28.01 per thousand board feet of plywood produced.

(e) The pattern continued and worsened. Finding X (R. 54-55), based upon the monthly balance sheets

and income statements (Exs. 131-C to 131-G), and supporting records (Exs. 132-A and 132-B), summarizes Sutherlin's losses as follows:

MONTH (1954)	Net Losses
January	$22,604.99
February	46,380.69
March	29,624.62
April	18,131.51
May	9,224.91
Total net losses	$125,966.72

On February 28, 1954, its cash account was overdrawn by $18.27 and its accrued payroll was $11,792.57 (Ex. 131-D). On March 31, 1954, the overdraw was $3,-801.72 and its accrued payroll was $10,890.97. Its current position was $53,117.59 current assets and $127,-323.70 current liabilities (Ex. 131-E). At this point appellant advanced an extra $11,000 for Sutherlin to meet its payroll secured by an assignment of current accounts receivable (Ex. 117; R. 176-177), but on April 30, 1954, when much of the normal expenses had stopped nine days previously, the cash account was only $169.41 and its current liabilities still exceeded its current assets by almost 100 per cent (Ex. 131-F). A month later after settling most of its accounts with appellant and Oregon Plywood Corporation and making two overdue payments on the mortgage (Finding

XXIX, R. 62) it still had only $409.15 cash and its current position turned out to be even worse. (Ex. 131-G).

Thus, after going through $91,000 in loans from the "Oregon Plywood" interests, collecting most of the collectible stock subscriptions (compare Ex 131-A and 131-G; R. 245) it had lost $125,966.72 — about one-fourth of its capital — in the course of only a few months. Its current account with appellant and Oregon Plywood Corporation was a virtual stand-off. Although its other accounts receivable were $8,147.54 it owed $45,117.66 to the trade and $12,772.93 in payroll taxes. The installments payable on the mortgage were $1,000 per month and within the next twelve months it would be required to pay $41,771.05 on installment sales contracts for its equipment (Ex. 131-G). It had no money to pay its $27,000 per month payroll (R. 178, 184), its insurance premiums (R. 178), glue for operations (R. 143, 180) the night watchman's wages (R. 193) or the electrical power to operate the machinery (R. 226).

Aside from the fact that it was in default on the mortgage, that installment sales contract creditors and other creditors were demanding payment (Ex. 137; R. 179) and that the federal government was demanding payment of the withholding taxes, it had twice been

threatened with labor liens for failure to meet its payroll and its electrical power had been shutoff (R. 178, 192). The creditors as a group began to take a hand in the matter at the meeting of June 11, 1954, pursuant to Sutherlin's invitation (Ex. 134-D; R. 197).

In short, Sutherlin's working capital was exhausted; it was broke; bankruptcy was feared (R. 219). Within the accepted definition of the term in equity courts it was insolvent because it could not pay its obligations in the regular course of business as they matured (Finding XIII, R. 56, Conclusion VII, R. 65).

21 *Words and Phrases* 624-630

Robert F. Hofheins, appellant's representative on Sutherlin's board of directors, agreed that the resolution of July 28, 1954 (Finding XVII, R. 57) authorizing sale or lease of the mill, was the only thing left to do (R. 201), and on the trial counsel for appellant stated:

> "Mr. Anderson: I don't doubt but what they were in serious financial difficulty, your Honor." (R. 181)

Appellees wish to add that this is *not* a case in which the assets of the corporation were drained off by excessive salaries to controlling executives. The

officers and directors of Sutherlin served entirely without compensation (R. 202).

Various theories were advanced at the trial to explain Sutherlin's failure. Apparently appellant contended it was the fault of Sutherlin's manager. However, there is no evidence that Mr. Hofheins ever suggested a change of manager (R. 182). If it were really important to know, Finding XXII (R. 59) concludes the issue by finding that it was through no fault of Sutherlin. The purchase of too much and too high priced veneer in a declining finished product market was one explanation (R. 184). Inadequate machinery, both as to type and quality, was another (R. 235-239). It is also possible that the inexperience of officers and directors in this field (R. 123, 131, 211) contributed to the losses and that some test for employment other than holding stock in the corporation would have aided the situation (Finding X, R. 55). However, the question is not whether Sutherlin could have done better but rather whether it did what it did in good faith.

The efforts to reopen the mill by obtaining additional financing both from banks and other organizations were many, but need not be detailed here except by citations to the record (See R. 127-128, 179, 192, 193, 226, 227). Appellant suggests that when the mar-

ket improved in the summer of 1954, as a result of the strike in the industry, it would have been a simple matter to reopen. Aside from the fact that neither it nor Robert Hofheins offered a plan for obtaining veneer with the industry on strike or offered a plan for financing (R. 226), there is no evidence that reasonable men would have foreseen the continued firm plywood market for any definite period. Further, Sutherlin's operations to date had shown an average loss per thousand board feet of plywood produced of $30.06 (Ex. 131-F). Based on an increase in the market price from $76 to $90 (R. 88) and even assuming that veneer prices were no higher than during Sutherlin's operations (an unlikely possibility), the best that Sutherlin could have expected was continued losses of over $16 per thousand board feet purchased. It is little wonder that the bankers were pessimistic as to Sutherlin's chances (R. 192).

Appellant's contention, then, is that Sutherlin was bound to produce at capacity for 60 months at a loss of at least $24,000 per month ($16/M x 1,500,000 feet) so that appellant could make a profit of $4,000 per month (App. Br. p. 50) — and this without being obligated to purchase anything and in return for nothing but the loan of money. We are confident that such result cannot be reached in a court of equity.

The foregoing summary demonstrates the correctness of the trial court's findings (Finding XXIII, R. 59-60) that in ceasing operations and selling the mill Sutherlin acted in good faith and, in fact, had no alternative but to do so or face continued additional losses and, ultimately, bankruptcy.

Appellant cannot prove its case, let alone upset the findings of the trial court, by Nordic's experiences. Sutherlin and Nordic are completely separate and different organizations. Nordic's financial statements (Ex. 133) show that its cash was never depleted as was Sutherlin's. Although it started in a rather poor current position, yet, with most of its obligations in one long-term non-interest bearing and flexible obligation to Sutherlin for the purchase price (Ex. 123), without Sutherlin's embarrassing loss record, and by operating at only a small loss for the first three months, on December 31, 1954, it had achieved (with financial assistance) $175,628.65 in current assets and $168,234.92 in current liabilities. In operations, with a very experienced plant manager, it made numerous changes by enlarging, improving, replacing, repairing and adding equipment (R. 234-239). Whereas, Sutherlin's best month, March, 1954, showed production at 1,553,678 board feet, Nordic's production for October, 1954 (second month of operation) was 1,980,377 board feet and

by December, 1954, it had increased to 2,534,493 board feet. It remained at that level thereafter and Nordic began making a profit (P.T.O. XII, R. 28; R. 233).

In short, their methods of operations and financial structures were so different that what Nordic did does not indicate what was or could have been done by Sutherlin.

II. Nordic Did Not Tortiously Interfere With or Induce A Breach of the Contract.

(See Specifications of Error Nos. V, VII, XVII, XVIII, XIX and XX).

A. The Purchase of the Mill did not Induce and Could not have Caused the Breach or any Damages to Appellant.

To have been entitled to relief against Nordic, appellant was required to prove

(1) that there was a breach of contract,

(2) that in the absence of Nordic's purchase of the mill the contract would have been performed by Sutherlin; and

(3) that Nordic, not Sutherlin, was the procuring cause of the breach.

Annotation: 84 ALR, 43-100, "*Liability for procuring breach of contract,*" at pp. 51-52; supplemented 26 ALR (2d), 1249-1251

Appellees have already shown that no breach of contract occurred (supra, pp. 9-47). Both the findings of the trial court and the evidence in the record negative the two additional matters appellant was required to prove.

First: As shown above, Sutherlin could not continue to operate. Even if it could be assumed that the loss per thousand board feet of plywood produced would have been reduced to an average of $16 after the industry strike occurred, such fact would neither assist in obtaining additional working capital nor prevent Sutherlin's liabilities, exclusive of capital stock, from quickly exceeding its remaining assets. The trial court found (Finding XXIII, R. 59-60), and this court can take judicial notice of the fact, that a manufacturing corporation can not continue on such basis and that, as found by the trial court (Finding XXII, R. 59), when Nordic first appeared on the scene, Sutherlin had already become disabled from furnishing appellant any output from its mill. Regardless of whether Sutherlin thereby breached some implied obligation to continue production, the fact remains that it was disabled and that Nordic's purchase of the mill had nothing to do with its being disabled. How, then, could Nordic's acts have caused damages to appellant? To have been en-

titled to relief appellant must have proved a causal connection between Nordic's acts and the loss.

Second: The findings of the trial court, unchallenged here, were that Sutherlin's production ended April 21, 1954, that in June, 1954, Sutherlin decided it would sell or lease its mill, if possible, and that from June forward it actively sought to find a possible buyer or lessee of the mill and invited offers therefor (Findings XII, XVI and XVII, R. 56, 57). Thereafter, in response to said invitations for offers, J. R. Adams and Norman H. Jacobson (who later caused Nordic to be incorporated) made an offer to Sutherlin which was accepted by Sutherlin (Findings XVIII and XIX, R. 58-59). The sale occurred after Nordic was incorporated.

These facts show and the trial court found that Nordic did not *induce* Sutherlin's refusal to produce or decision to sell the mill, that there was no tortious conspiracy or collusion between Sutherlin and Nordic, that there could have been no causal connection between Nordic's acts and any breach of contract or damages to appellant and that appellant has failed to prove the contrary (Findings XXVI, XXVII, R. 60-61).

If a party to a contract has already voluntarily withdrawn or determined to withdraw from performance of his contract, others who subsequently deal with such

party so that he can not in any event perform that contract incur no liability for such acts. This is so whether the others know of the prior inconsistent contract or not.

Prosser on Torts (1941) p. 986, § 104

> "In order to be held liable for interference with a contract, the defendant must be shown to have caused its nonperformance. It is not enough that he merely has reaped the advantages of the broken contract after the contracting party has withdrawn from it of his own motion. Thus acceptance of an offered bargain is not in itself inducement of the breach of a prior inconsistent contract, although the defendant may be liable if he has taken an active part by holding forth an incentive, such as the offer of a lower price or better terms. It seems probable, although the question does not appear to have arisen, that the mere statement of existing facts in such a way that the party persuaded recognizes them as a reason for breaking the contract is not enough, so long as the defendant creates no added reason by his conduct."

4 *Restatement of Torts*, § 766, Comment i.

> "*Making agreement with knowledge of the breach.* One does not induce another to commit a breach of contract with a third person under the rule stated in this Section when he merely enters into an agreement with the other with knowledge that the other cannot perform both it and his contract with the third person (compare Comment h). For instance, B is under contract to sell certain goods to C. He offers to sell them to A, who knows of the contract. A accepts the offer and receives the goods.

A has not induced the breach and is not subject to liability under the rule stated in this Section (compare Restatement of Contracts, Sec. 576)."

The "conspiracy" which results from mere knowledge that the subsequent contract is inconsistent with the prior one, if such it is called, is not a legally tortious one.

A leading case recognizing this principle is

Sweeney v. Smith, (C.C. E.D. Pa., 1909) 167 Fed. 385, affirmed (CCA 3, 1909) 171 Fed. 645, cert. den. (1909) 215 U. S. 600, 54 L. Ed. 343

There, the plaintiff had contracted with a bondholders' committee to purchase bonds of a street railway at a 60 per cent discount, but the committee had subsequently sold them to the defendant, E. B. Smith & Co. The plaintiff's bill sought to compel E. B. Smith & Co. to account for the profits from the purchase and sale of the bonds and alleged:

(p. 386) " 'The said Edward B. Smith & Co. knew before they entered upon their negotiations of your orator's contract, * * * and their negotiation with said committee was conducted through one D. L. Groner and one Tazewell Taylor, both of whom knew of your orator's said contract before they entered upon the said negotiations.' "

In sustaining a demurrer to the bill, the court reviewed the authorities and held such knowledge to be insufficient to impose liability.

"Under all the authorities the bill is fatally defective on this point. * * * It must be founded on a tort, on a wrong done by Smith & Co., and must be supported by the proposition that it is an actionable wrong to make a second contract with a promisor if he is known to have had a prior contract upon the same subject with another promisee. In my opinion, this proposition is not sound. The promisor may have excellent reasons for declining to be bound by the earlier contract, and these he need not disclose. If he chooses to take the risk of breaking the first agreement, that is his own affair, which may make him liable on that agreement, but imposes no obligation on the second promisee. * * * Mere knowledge of the first does not make the second an actionable wrong; he is under no legal obligation to insist upon being told why the promisor declines to carry out the first contract, and is not bound to weigh these reasons and decide at his peril whether they are good or bad.

* * *

"* * * Without deciding now between the conflicting views, it is enough to say that no case can be found, I think, in which the action has been sustained unless the interference has been wrongful in a legal sense. At the least, the interferer must have induced or persuaded the breach complained of. If he accomplish his purpose by fraud in any of its forms (as was the case in Angle v. Railroad, 151 U. S. 1, 14 Sup. Ct. 240, 38 L. Ed. 55), his liability is undoubted; but I have been referred to no decision, and I have found none, in which mere knowledge of the earlier contract was held to be the equivalent of inducement or persuasion or (still less) of fraudulent conduct."

To the same effect are

Ford v. Wilson & Co., (CCA 2, 1942) 129 F. (2d) 614, 617

Horth v. American Aggregates Corporation, (Ohio App., 1940), 35 N.E. (2d) 592, 598

B. J. Wolf & Sons v. New Orleans Tailor-Made Pants Co., (1904) 113 La. 388, 37 So. 2

In fact, there is even serious doubt whether a state can constitutionally impose liability on a third party merely on the grounds that it knew of a prior contract which could not be performed if property were purchased. Vicarious liability for the purchase of unencumbered property can not be extended to such extreme.

Minnesota Wheat Growers' Co-op Marketing Ass'n v. Radke, (1925) 163 Minn. 403, 204 N.W. 314

In that case a co-operative marketing statute imposed a penalty and liability to the co-operative on any dealer, prospective purchaser or other person conducting a warehouse who (P. 314)

> " '* * * solicits or persuades or permits any member of any association organized hereunder to breach his marketing contract with the association by accepting or receiving such member's product for sale * * *.' "

The court held that, as applied to one who did not induce the withdrawal from the co-operative by the

members of the co-operative but merely contracted to purchase the members' products with knowledge that said members had contracted to market them through the co-operative, the statute was unconstitutional (P. 315).

> "Of course, it is well settled that a malicious interference by one not a party to a contract to induce its breach is a tort for which redress may be had. Canellos v. Zotalis, 145 Minn. 292, 177 N. W. 133; Bacon v. St. Paul Union Stockyards Co. (Minn.) 201 N. W. 326. But section 27 does not stop with those who maliciously interfere with existing contracts between third parties. It makes it an actionable wrong for one who has used no effort, or held out no inducement for a member of a co-operative market association to breach his contract with the association, except this, that he is ready at his usual place of business to buy or handle products that such member may voluntarily bring there for sale or disposal, the same as for an outsider. * * *
>
> "* * * an outsider brings to the latter's place of business for sale or disposal a commodity which is under contract for delivery to his association, he has breached his contract with it, and must be held to have so breached it voluntarily.
>
> "It seems clear to us that it is beyond the power of the Legislature to make it a tort to purchase, in the ordinary course of a legitimate business, from the true owner a wholesome staple commodity upon which there is no lien and which is not under any ban or regulation because of inherent qualities or use."

A similar statute was upheld as constitutional by the Wisconsin court in

Northern Wisconsin Co-op Tobacco Pool v. Bekkedal, (1923) 182 Wis. 571, 197 N. W. 936

as applied to malicious activities, and an injunction against them was upheld. However, on rehearing, the court modified the decree and held

> (P. 946) "If a member should voluntarily sever his relations with the pool, by breaching his contract, and withdrawing his membership therein, and placing his tobacco for sale upon the market, no reason is perceived why appellants should be denied the privilege of buying his crop. To that extent and for that purpose the injunctional order or judgment is amended, * * *."

It will be noted that appellant makes no contention that there was any equitable lien or servitude that ran with the mill property. If it did, the contention would fail.

First Nat. Bank v. Hazelwood Co., (1917) 85 Or. 403, 166 Pac. 955

In summary, appellant's proposition that Nordic's purchase of the mill could legally have been the inducement of a breach of a completely collateral contract concerning the "output" of the owner of the mill, where there was no promise not to sell or assign, is novel, to

say the least. No case has been found imposing liability therefor. The case is unlike *Texas Industries v. Brown*, (CA 5, 1955) 218 F. (2d) 510 (cited App. Br. p. 34) and *McKenney v. Buffelen Manufacturing Co.*, (CA 9, 1956) 232 F. (2d) 5, in that in both cases the contract contained express provisions covering the transfer of assets. Even assuming, however, that liability is possible in such case, Nordic's acts were not legally tortious as to appellant in this case because

> (1) It failed to prove that Sutherlin could have furnished it with any further production and the trial court found that it could not have done so.
>
> (2) It failed to prove that Nordic's acts induced or caused the closure or sale of the mill and the trial court found that Sutherlin was the moving party.

B. Nordic Was Privileged to Purchase the Mill.

As noted above, any inducement of breach of contract resulting from the purchase of property used in the performance of a contract, not accompanied by an agreement that the seller will not produce with other assets, is extremely incidental to the buyer's conduct.

The trial court found that Nordic purchased the mill in good faith, for its own purposes and without any purpose of injuring appellant (Finding XXVII, R. 61). It concluded that Nordic was privileged to purchase the mill (Conclusion IX, R. 65). Evidence supporting this

finding includes the fact that prior to the purchase its incorporators obtained and relied upon legal opinions that it would not be interfering with any legal rights of appellant (Ex. 136, R. 230), the fact that its incorporators invested a substantial sum of money to effect the purchase (R. 231, 238), and the fact that Sutherlin had become disabled from producing further (Finding XXII, R. 59).

When the breach is merely incidental to a defendant's conduct there is no liability, provided

(1) That the defendant has used no means which are tortious in and of themselves as to some person, and

(2) That the defendant has sought only to advance his own legitimate economic interests, and has not acted with the primary purpose of inducing the breach or injuring the plaintiff.

Some cases apparently have proceeded on the theory that there is no prima facie tort in such case, whereas others have deemed the situation one of privilege.

Prosser on Torts (1941) 994-996, Sec. 104

4 *Restatement of Torts*, § 766, Comment d

cf. DeMarais v. Stricker (1936) 152 Or. 362, 53 P. (2d) 715

Even when the means are "wrongful" in the sense that they involve a breach of a contract by the defendant, there is no liability for such incidental interference.

R. J. Caldwell Co. v. Fisk Rubber Co., (CCA 1, 1933) 62 F. (2d) 475, 477

The plaintiff in that case sought to recover lost sales commissions because the defendant intentionally breached its contract with the plaintiff's manufacturer. In affirming a directed verdict in favor of the defendant, the court stated:

> "There is no evidence, and no contention, that in taking that step Fisk acted under any other motive or purpose than the protection of its own interests. Apparently, its managers decided they would rather break the contract and pay the damages, than go on with the large deliveries which it was obligated to take—a situation by no means unprecedented.
>
> "The fact that Caldwell's interests would be adversely affected by the Fisk Company's breach of its contract, and that this fact was known to the Fisk Company, did not render the Fisk Company liable to Caldwell."

To the same effect are

> *New York Trust Co. v. Island Oil & Transport Corporation*, (CCA 2, 1929) 34 F(2d) 649, 652, cert. den. (1930) 281 U.S. 724, 74 L. Ed. 1142 (mortgagee has no independent rights for defendant's breach of contract with mortgagor)
>
> *Dewey v. Kaplan*, (1937) 200 Minn. 289, 274 N.W. 161 (third party's competition in violation of pro-

vision in lease gives no rights to lessor whose lessee rescinds therefor)

Kokomo Rubber Co. v. Anderson, (1924) 33 Ga. App. 241, 125 S.E. 783 (lessor has no action against hold-over tenant whereby lessee for subsequent period rescinds)

The mere purchase of property known to be necessary if the seller is to perform his contract with a third party has never, so far as we have found, subjected the purchaser to liability if he acted only in the furtherance of his own legitimate interests and had no purpose to injure the third party. The ramifications of a contrary rule would be virtually limitless.

III. In Any Event, the Relief Requested Is Neither Appropriate Nor Supported by the Evidence.

(See Specifications of Error Nos. XVII, XVIII, XIX and XX.)

The trial court made no findings with respect to the amount or measure of damages or the facts determining the appropriateness of equitable relief. Even if it were possible to make such findings from the present record, it is not the function of this court to do so.

Deering-Milliken & Co. v. Modern-Aire of Hollywood, (CA 9, 1955), 231 F. (2d) 623, 627

Nevertheless, we will show that, in any event, appellant would not be entitled to more than nominal damages or to injunctive relief.

A. The Damages, If Any, Cannot Be Measured With Reasonable Certainty.

It is only in its section on the measure of damages (App. Br. pp. 48-51) that appellant suggests exactly what "output" was supposed to mean, and that suggestion is that it was to be what the mill "could have handled" (App. Br. p. 49). It is quite obvious that the parties would have used the term "capacity" instead of "output" if such had been intended. In any event, appellant has cited no case which has set a measure of damages for the breach of either an output or requirements contract *where the person suing is the output buyer or the requirements seller*. In fact, it has cited no case in which damages were actually awarded to such plaintiff.

Even cases such as *Wells v. Alexandre*, (1891) 130 N.Y. 642, 29 N.E. 142 (cited App. Br. p. 29) provide no measure of damages for the present case because they measure the required production by that at the time the contract was made, whereas here there had been nothing produced at or prior to the making of the contract.

Only damages which can be estimated with reasonable certainty are recoverable. It cannot be foretold with such certainty that a new business will continue at any particular level of productivity or at all. See 5 *Corbin on Contracts*, § 1023, n. 96. Here there is no certainty that Sutherlin could have continued to have an output for appellant to sell at a profit, and the trial court found that it had become disabled from doing so (Finding XXII, R. 59). This fact negatives the recovery of more than nominal damages from Sutherlin if the word "output" is given its natural meaning. In any event, it prevents recovery from Nordic. If Sutherlin could not have produced, *at capacity or otherwise*, it cannot be said that in the absence of Nordic's purchase of the mill appellant would have had any plywood production on which to make its 5 per cent commission.

B. Injunctive Relief Is Inappropriate and Is Barred by Appellant's Conduct.

As the trial court found (Findings XVI, XVII, XVIII, XXVI, XXVII, R. 57-58, 60-61) and as shown above (see pp. 47-59), Nordic's purchase of the mill was not tortious. Hence, there is no wrong to be enjoined.

In any event, such relief would be peculiarly inappropriate and harsh here. Appellant's contract was with

Sutherlin, not with Nordic. When it contracted with Sutherlin with full knowledge of its lack of working capital, it took its chances that Sutherlin would fail (Finding VIII, R. 53; R. 72, 203).

The many differences between Sutherlin and Nordic in management, method of operation, equipment and financial structure have been shown above (see pp. 46-47). Appellant should not now be entitled to invoke its prerogatives upon a completely different organization, not connected with the first, and thereby receive a windfall. It has cited no case which would support such relief, and such would be contrary to the basic principles of equity. In fact, the case most relied upon by appellant, *Diamond Alkali Co. v. P. C. Thomson & Co., Inc.*, (CCA 3, 1929) 35 F. (2d) 117, 120, recognized that such could not be done.

Further, appellant's conduct bars its resort to equity for such relief. The record shows that Robert F. Hofheins (appellant's representative on Sutherlin's board of directors) did nothing to improve the management of which it complains or to assist in reopening the mill after it was compelled to shut down, and he was often absent from meetings of the board (see Finding XV, R. 57; Exs. 134C, 134D, 134H, 139, 140 and 129F; and R. 191, 197, 198, 202, 212, 216-217, 221, 224 and 226). Further, he made no protest to the orders to stop buying

veneer or the discussion of closing down (R. 191, 212) or to the resolution to sell the mill (R. 201). He agreed that there was nothing else to do (R. 201, 224). He was not present when the offer from Adams and Jacobson was accepted (Ex. 134H), but he had been present at the time the original resolution to sell the mill was adopted, and he and his corporations received specific notice of the pending sale to Nordic when Sutherlin sent its notice to creditors in compliance with the bulk sales law (Ex. 118). No objection was made. Under such circumstances, appellant was guilty of laches and should be held estopped.

19 *Am. Jur.*, Equity, Section 498, p. 343

CONCLUSION

The judgment and decree of the District Court should be affirmed.

(1) The sales contract was an *output* contract under which Sutherlin was obligated to sell to appellant 80 per cent of its actual production but was not prevented from decreasing or having no output or from selling its mill, provided it did so in good faith.

(2) There is no evidence that Sutherlin's forced shutdown, its inability to produce or the sale of its mill was

the product of bad faith, and all the evidence supports the finding of good faith.

(3) The evidence supports the findings that Sutherlin had already become disabled from producing and had decided to sell its mill before Nordic agreed to purchase the mill and even before it was incorporated. Therefore, Nordic did not induce Sutherlin to shut down, to fail to reopen or to sell its mill, and its purchase of the mill could not have been the proximate cause of any breach of contract by Sutherlin.

(4) The evidence supports the finding that Nordic purchased the mill only for the purpose of furthering its legitimate economic interests and without any purpose of injuring appellant or its rights in the sales contract. Therefore, Nordic's acts were privileged.

(5) There are no findings on the issue of damages. However, it cannot be estimated with reasonable certainty that there were any or a particular amount of damages to appellant, and the evidence supports the finding that Sutherlin had become disabled from producing prior to the sale of the mill. Therefore, no more than nominal damages are recoverable from Sutherlin and none are recoverable from Nordic.

(6) There are no findings on the issue of injunctive

relief, but, in any event, injunctive relief should not be given against Nordic because:

(a) Such would provide appellant with a windfall to which it is not entitled, and

(b) Appellant is guilty of laches and its conduct estops it from obtaining the aid of equity.

Respectfully submitted,

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